Lin Wen-Chih & Anor v Pacific Forest Industries Sdn Bhd (formerly known as Veramax Sdn Bhd) & Anor

COURT OF APPEAL (PUTRAJAYA) — CIVIL APPEAL NO S-02–564 OF 2000
TENGKU BAHARUDIN SHAH, JAMES FOONG AND ZALEHA ZAHARI JJCA
28 MAY 2008

Civil Law Act — Contract — Frustrated contract — Claim for moneys due and owing — Claimant deducting value of benefit obtained from defendant from total debt owing — Whether claim allowable by law — Civil Law Act 1956 s 15

Contract — Frustration — Impossibility — Parties agreeing to sell and purchase products at 'prevailing market price' — Parties subsequently disagreeing on market price — No provision in contract concerning assessment of market price — Whether contract frustrated — Whether futile for parties to continue with contract — Contracts Act 1950 ss 33 & 57(2)

The appellant entered into an agreement for the sale of shares ('the agreement') with the first respondent and a third party. Simultaneous to the execution of the agreement, the first respondent issued P2 to the appellants confirming, inter alia: (i) that an outstanding sum of RM10,134,000 was due and owing to the appellants; (ii) that the first respondent would sell and the appellant would purchase timber products at a price consistent with the prevailing market price, over a period of ten months from the date of P2 and over four shipments; (iii) that the price of the timber products would be deducted from and set-off against the outstanding sum owed to the appellants; and (iv) that in the event the first respondent failed to deliver or delivered defective timber products, the first respondent would pay cash in lieu of the timber products. The second respondent gave a corporate guarantee to the appellants for the first respondent's performance. Within the ten months stipulated in P2, only one order with the first respondent was concluded. The rest failed as the parties could not agree on the price of the timber products. The appellants demanded payment of the balance outstanding sum and subsequently filed suit in the High Court. The High Court dismissed the appellants' claim on, inter alia, the grounds that: (i) the appellants had not complied with the terms stipulated in P2; and (ii) the events that could have triggered the payment of cash by the first respondent had not arisen. The appellants thus appealed to the Court of Appeal.

Held, allowing the appeal with costs:

(1) The first respondent had indeed acknowledged its indebtedness to the appellants. The debt owed was to be repaid by way of a set-off on terms prescribed by P2. However, only one transaction was concluded as the parties could not agree on the price for the timber products. Since parties disagreed on such a fundamental term and there was no provision in the agreement (SP2) to settle such disagreement, the agreement would be regarded as frustrated. Since the price could not be agreed, naturally there could be no purchase of the first respondent's timber products for the purpose of set-off. In the instant case, ss 33 and 57(2) of the Contracts Act 1950 were applicable (see para 12).

(2) The High Court's decision that the appellants' claim was premature due to the appellants' failure to conclude the remaining transactions for the purpose of the set-off was erroneous. Any further attempts to transact between the parties would again fail on the issue of price. It was futile for the parties to continue with the contract (see para 14).

(3) The appellants' claim was within the provisions of the law (see s 15 of the Civil Law Act 1956) since they had debited the value of the timber products from the only transaction from the total debt (see para 16).

(4) The High Court had decided that the appellants' failure to purchase the first respondent's goods within the time specified in the agreement (SP2) would not discharge the debt since there was no specific provision to this effect in the agreement. The court would uphold such views of the High Court (see para 17).

(5) Since the first respondent was indebted to the appellants for the amount claimed, the second respondent, as guarantor for the performance of the first respondent was also liable to the appellants. The second respondent's contention that it had not received a letter of demand from the appellants was contrary to the evidence which showed otherwise (see paras 18–19).

[Bahasa Malaysia summary

Perayu telah memasuki perjanjian untuk jualan saham ('perjanjian tersebut') dengan responden pertama dan pihak ketiga. Serentak dengan penyempurnaan perjanjian, responden pertama telah mengeluarkan P2 kepada perayu-perayu mengesahkan, antara lain: (i) bahawa jumlah yang belum dijelaskan sebanyak RM10,134,000 yang perlu dibayar dan terhutang kepada perayu-perayu; (ii) bahawa responden pertama akan menjual dan perayu akan membeli hasil kayu balak pada harga yang konsisten dengan harga pasaran semasa, sepanjang tempoh sepuluh bulan dari tarikh P2 dan dalam empat penghantaran; (iii) bahawa harga hasil kayu balak akan ditolak

daripada dan dipotong daripada jumlah yang belum dijelaskan terhutang kepada perayu-perayu; dan (iv) bahawa sekiranya responden pertama gagal untuk menghantar atau menghantar hasil kayu balak yang rosak, responden pertama akan membayar tunai sebagai ganti hasil kayu balak tersebut, Responden kedua telah memberikan jaminan korporat kepada perayu-perayu terhadap pelaksanaan responden pertama. Dalam tempoh sepuluh bulan yang ditetapkan dalam P2, hanya satu pesanan dengan responden pertama selesai. Selainnya gagal kerana pihak-pihak tidak bersetuju dengan harga hasil kayu balak tersebut. Perayu-perayu menuntut bayaran baki jumlah yang belum dijelaskan dan berikutan itu memfailkan guaman di Mahkamah Tinggi. Mahkamah Tinggi telah menolak tuntutan perayu-perayu untuk, antara lain, alasan-alasan bahawa: (i) perayu-perayu tidak mematuhi terma-terma yang ditetapkan dalam P2; dan (ii) peristiwa-peristiwa yang mungkin mencetuskan bayaran tunai oleh responden pertama tidak timbul. Perayu-perayu oleh itu telah merayu ke Mahkamah Rayuan.

Diputuskan, membenarkan rayuan dengan kos:

(1) Responden pertama sememangnya telah sedia maklum tentang keberhutangannya kepada perayu-perayu. Hutang yang tertunggak hendaklah dibayar balik melalui tolakan berdasarkan terma-terma yang ditetapkan oleh P2. Walau bagaimanapun, hanya satu transaksi yang selesai kerana pihak-pihak tidak bersetuju dengan harga untuk hasil kayu balak tersebut. Memandangkan pihak-pihak tidak bersetuju dengan terma penting tersebut dan tiada peruntukan dalam perjanjian ('SP2') untuk menyelesaikan pertikaian sedemikian, perjanjian tersebut boleh dianggap terkecewa. Memandangkan harga tersebut tidak boleh dipersetujui, sewajarnya tidak ada belian hasil kayu balak responden pertama untuk tujuan tolakan. Dalam kes ini, ss 33 dan 57(2) Akta Kontrak 1950 adalah terpakai (lihat perenggan 12).

(2) Keputusan Mahkamah Tinggi bahawa tuntutan perayu-perayu adalah pra matang akibat kegagalan perayu-perayu menyelesaikan transaksi-transaksi lain bagi tujuan tolakan adalah salah. Apa-apa percubaan seterusnya untuk berurusan antara pihak-pihak akan gagal lagi atas isu harga. Adalah sia-sia untuk pihak-pihak meneruskan kontrak tersebut (lihat perenggan 14).

(3) Tuntutan perayu-perayu adalah dalam peruntukan undang-undang (lihat s 15 Akta Undang-Undang Sivil 1956) memandangkan mereka telah mendebitkan nilai hasil kayu balak daripada hanya satu transaksi daripada keseluruhan jumlah hutang (lihat perenggan 16).

(4) Mahkamah Tinggi telah memutuskan bahawa kegagalan perayu-perayu untuk menjual barangan responden pertama dalam tempoh yang ditetapkan dalam perjanjian (SP2) tidak melangsaikan hutang tersebut memandangkan tidak terdapat peruntukan spesifik untuk tujuan ini dalam perjanjian tersebut. Mahkamah Rayuan akan mengekalkan pendapat-pendapat Mahkamah Tinggi (lihat perenggan 17).

(5) Memandangkan responden pertama terhutang kepada perayu-perayu untuk jumlah yang dituntut, responden kedua, sebagai penjamin untuk pelaksanaan responden pertama juga bertanggungjawab kepada perayu-perayu. Hujah responden kedua bahawa ia tidak menerima surat tuntutan daripada perayu-perayu adalah bertentangan dengan keterangan yang ditunjukkan sebaliknya (lihat perenggan 18–19).]

Notes

For a case on frustrated contract, see 1 *Mallal's Digest* (4th Ed, 2005 Reissue) para 3542.

For cases on impossibility under frustration of contract, see 3(2) *Mallal's Digest* (4th Ed, 2006 Reissue) paras 3773–3779.

Legislation referred to

Civil Law Act 1956 s 15
Contracts Act 1950 ss 33, 57(2)

Appeal from: Civil Suit No T(22)–12 of 1997 (High Court, Tawau)

Henry Lim (Shim, Pang & Co) for the appellant.
Chin Yuen Fong (Chin Lau Wong & Co) for the respondent.

James Foong JCA (delivering judgment of the court):

INTRODUCTION

[1] On 29 March 2007, we allowed this appeal with costs. We now give our reasons for doing so. We will commence with the brief background facts, followed by the pertinent ground relied on by the trial judge in his judgment and then our reasons for allowing this appeal.

BRIEF BACKGROUND FACTS

[2] The first respondent is a private limited company involved in the business of manufacturing plywood in East Malaysia. The appellants were at one time its directors and shareholders. When the appellants decided to sell their shareholdings in the first respondent to a third party, the first

respondent by letter dated 28 August 1996 (exh P1) confirmed that a sum of RM10,134,000 is due and owing to the appellants in the following proportion:

(a) to the first appellant a sum of RM5,134,000;

(b) to the second appellant a sum of RM5,000,000.

[3] Simultaneous to the execution of the shares sale agreement between the appellants and the third party purchaser, the first respondent on 12 November 1996 issued a letter (exh P2) to the appellants confirming the following:

(1) acknowledging RM10,134,000 as the outstanding sum due to the appellants in the proportion listed above;

(2) that interest on the outstanding sum at 11% per annum will be paid;

(3) under para 2, 'we shall sell and you shall purchase timber products manufactured by us (the timber products) at a price consistent with the prevailing market price and costing the same amount as the Outstanding Sum plus the Agreed Interest (the Timber Product Price) from us over a period of ten (10) months from today and to be delivered over four (4) shipments';

(4) under para 3, 'the Timber Products Price shall be deducted from and set-off against the Outstanding Sum and the Agreed Interest';

(5) under para 4, 'subject to item 5 hereinafter contained, the Outstanding Sum and the Agreed Interest shall be repaid by us to you only by way of deduction from and set-off against the Timber Products Price';

(6) under para 5, 'in the event that we shall fail, refuse and/or neglect to supply any of the Timber Products ordered by you or if any of the Timber Products supplied by us shall not be in accordance with the specifications stated in your purchase order(s), you shall be entitled, after giving us thirty (30) days' notice in writing to supply the Timber Products or replace the defective Timber Products and we have failed to do so, to cancel the order for such Timber Products or reject such Timber Products. Upon the order for such Timber Products being cancelled or such Timber Products being rejected and returned to us, we shall then pay cash in lieu of such Timber Products to you and such cash payment shall be deducted from and set-off against the Outstanding Sum and the Agreed Interest'.

[4] Also on the same day (12 November 1996), the second respondent gave a corporate guarantee to the appellants which says 'in the event that the Company (1st respondent) shall fail to pay you the Timber Products Price

and/or The Agreed Interest in full by the time stipulated in the Company's letter, we shall pay you the same or any balance thereof then outstanding within fourteen (14) days from our receipt of written notice from you to do so'. A

[5] Within the period of ten months stipulated in exh P2, only one order by the appellants with the first respondent was concluded. The rest failed for the principal reason that the parties could not agree on the price of the products. B

[6] On 15 September 1997, the appellants gave notice to the first respondent demanding payment of the balance outstanding sum of RM6,144,489 (after having set-off the amount debited under the one concluded transaction between the parties). They claimed that despite their numerous endeavours, the first respondent had ignored, refused or failed to pay them this amount. A demand on the second respondent, as guarantor, was also made. C D

[7] When such demands were not met, the appellants filed this suit in the High Court requesting for RM6,223,241 with agreed interest and costs. E

[8] The defence of the first defendant is basically these:

(1) A denial that the appellants are entitled to their claim.

(2) Further and in the alternative, the repayment of the indebtedness was to be effected by way of a set-off equivalent to the value of timber products which the appellants were obliged to buy over a period of ten months but during this time frame, the appellants had only concluded one transaction where the cost of which was about only *Vi* of the amount of the debt. Thus, due to the appellants' omission to purchase from the first respondent, the balance of the indebtedness is discharged. F G

(3) Further, since the timber products supplied or to be supplied to the appellants were never cancelled or were defective which were not replaced, the appellants are not entitled to receive cash from the first respondent in lieu of set-off with the timber products. H

[9] As for the second respondent, aside from relying on the defences of the first respondent, the second respondent also took issue with the appellants for failing to issue a letter of demand to them. I

[10] After a full trial, the High Court dismissed the appellants' claim with costs.

THE HIGH COURT'S REASON

[11] The main ground for the dismissal of the plaintiff's claim by the High Court is found in the following passages of the High Court's judgment.

> Accordingly, I find that the parties considered themselves bound by the terms as stated in exh P2 and in fact acted upon them. And although PW1 said that they had no choice but to agree since they were eager for the payment, nevertheless, I am of the view that having taken that position it would have been a matter of observing the terms therein. Nothing could have prevented them from placing their orders and waited for the first defendant to meet them. As such I do not think it can be summarily dismissed the notion that exh P2 formed the basis of an agreement of the parties pertaining to the settlement of the outstanding sum. Indeed I would say that exh P2 may be an admission on the part of the first defendant but it was subject to certain conditions which the plaintiffs subsequently accepted, if not in writing then through their conduct.
>
> Hence, I am inclined to agree with the contention of learned counsel for the first defendant that since the plaintiff failed to comply with the terms stipulated in exh P2 within the specific or within reasonable time after the expiry and since it was not shown that the events that could have triggered the payment of cash had arisen the claim should therefore be taken as premature.

OUR REASONS

[12] We dissagree with the reason proffered by the High Court in this respect. First, it is not in dispute that the first respondent had acknowledged indebtedness of a sum of RM10,134,000 to the appellants. However, this was to be repaid by way of a set-off according to the manner as spelled out in exh P2. Out of a total of four attempts to purchase the first respondent's timber products, only one transaction was concluded for the purpose of this set-off. Evidence disclosed that this was due to the failure of the parties to agree on the price. According to the appellants, the prices quoted by the first respondent were too high. They were inconsistent with those prevailing in the market at the material time. This was the price agreed upon by the parties under exh P2. We are of *the view that when the parties disagree on this fundamental term and there is no* provision in the agreement to settle this, then the agreement is frustrated. It was not due to a lack of trying or the fault of any one party but just that the contractual obligation has become impossible to perform due to the absence of a mechanism in the agreement to settle this dead lock. When the price cannot be agreed then naturally there can be no

purchase of the first respondent's timber products for the purpose of set-off. Under such circumstances, s 57(2) of the Contracts Act 1950 ('the Act') applies. This section provides:

> A contract to do an act which, after the contract first made, becomes impossible, or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful

[13] Another provision that is applicable here is s 33 of the Act which says:

> (a) Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event happened.
>
> (b) If the event becomes impossible, such contracts become void.

[14] Further, we are of the view that the opinion of the High Court that the appellants' claim first premature due to their failure to conclude the remaining transactions for the purpose of set-off first erroneous in this respect: that any further attempts to transact between the parties will again fail on the issue of price. It first futile for the parties to continue with the contract. This matter will never be settled.

[15] When the agreement is discharged by frustration, then s 15 of the Civil Law Act 1956 applies. This provision states:

> (1) Where a contract has become impossible of performance or been otherwise frustrated, and the parties thereto have for that reason been discharged from the further performance of the contract, subsections (2) to (6) shall, subject to section 16, have effect in relation thereto.
>
> (2) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged (in this Act referred to as 'the time of discharge') shall, in the case of sums so paid, be recoverable from him as money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable:
>
> Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the Court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

A (3) Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than payment of money to which subsection (2) applies) before the time of discharge, there shall be recoverable from him by the said other party such sum
B (if any), not exceeding the value of the said benefit to the party obtaining it, as the Court considers just, having regard to all the circumstances of the case and, in particular:

C (a) the amount of any expenses incurred before the time of discharge by the party benefited in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under subsection (2); and

D (b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

(4) In estimating, for the purposes of subsections (1) to (3), the amount of any expenses incurred by any party to the contract, the Court may,
E without prejudice to the generality of the said subsections, include such sum as appears to be reasonable in respect of overhead expenses and in respect of any work or services performed personally by the said party.

F (5) In considering whether any sum ought to be recovered or retained under subsections (1) to (4) by any party to the contract the Court shall not take into account any sums which have, by reason of the circumstances giving rise to the frustration of the contract, become payable to that party under any contract of insurance unless there was
G an obligation to insure imposed by an express term of the frustrated contract or by or under any enactment.

(6) Where any person has assumed obligations under the contract in consideration of the conferring of an benefit by any other party to the contract upon any other person, whether a party to the contract or
H not, the Court may, if in all circumstances of the case it considers it just to do so, treat for the purposes of subsection (3) any benefit so conferred as a benefit obtained by the person who has assumed the obligations as aforesaid.

I

[16] Applying this to the appellants' claim, we came to the conclusion that what the appellants are claiming first within the provision of the law since they have debited the value of the timber products from the only transaction between the parties from the total debt.

[17] On the issue of the debt being discharged by the appellants' omission to purchase the first respondent's goods within the specified time stated in the agreement, we uphold the following views expressed by the High Court:

> In any event I should think that the imposition of the time frame in exh P2 for the plaintiffs to place their orders does not necessarily mean that the same has become a limitation period for the parties in the sense that the claim would be automatically barred on expiry of that period. In the case of *New Zealand Insurance Co Ltd v Ong Choon Lin (t/a Syarikat Federal Motor Trading)* [1992] 1 MLJ 185 it was held that] cl 19 of the insurance policy that provided the time frame to commence an action from the date of occurrence of loss or damage contravened the provision of s 29 of the Contracts Act 1950 and thus void. And in this case it was not specifically stated in exh P2 that failure to place the orders within the time stipulated would result in extinguishment of the outstanding sum.

[18] Since the first respondent first indebted to the appellants for the amount claimed, the respondent, as guarantor for the performance of the first respondent, first also liable to the appellants.

[19] The second respondent has insisted that it did not receive a letter of demand from the appellants. We are surprised at this allegation when exh P6, which first a letter of demand by the appellants' solicitors dated 27 October 1997 to the second respondent, clearly shows otherwise. Further, there first an acknowledgment of receipt of this letter of demand by the second respondent. We would also like to add that the second respondent called no witness at the trial to rebut the evidence of the appellants. In the light of this, we find this contention of the second respondent without merit.

CONCLUSION

[20] For reasons stated aforesaid, we allowed the appellants' appeal with costs here and below, set aside the order of the High Court dated 29 July 2000 and, entered judgment in favour of the appellants as claimed.

Appeal allowed with costs.

Reported by Andrew Christopher Simon